

403(b) Perspectives

Insights into the Administration of §403(b) Tax-Sheltered Arrangements

SUMMER 2009

Form 5500 Transition Relief for 403(b) Plans

Plan year 2009 is the first year that 403(b) arrangements are required to file Form 5500 in its entirety. There has been a growing concern in the industry about the handling of the impossible, i.e., how will employers possibly gather financial information on old contracts and custodial accounts for purposes of adding the totals for the Form 5500 required financials. Thus, there was a great need for guidance. On July 20, 2009, the DOL issued Field Assistance Bulletin 2009-2 to provide Form 5500 transition relief for 403(b) arrangements for 2009.

In FAB 2009-2, the DOL stated that it understands that administrators of 403(b) plans, subject to Title I of ERISA, face compliance challenges in transitioning to ERISA's generally applicable annual reporting requirements for the 2009 plan year. Therefore, the DOL has provided transition relief for administrators of 403(b) plans that make good-faith efforts to transition to the Form 5500 requirements for the 2009 plan year. This relief is limited to the Form 5500 annual reporting requirements, including the large-plan requirement to include the report of an independent qualified public accountant.

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403(b) Prototype Plan — Draft Stage

On April 14, 2009, the IRS issued Announcement 2009-34 to introduce the IRS Prototype 403(b) Program and to issue a draft Revenue

Procedure for this program. The IRS also issued a draft of the 403(b) prototype language [known as the List of Required Modifications (LRMs)]. The IRS asked for comments on both of

these drafts. The IRS received numerous comments from various practitioner and industry groups, such as ASPPA, as well as law firms, and other interested parties.

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Transition Relief Rule

The administrator of a 403(b) plan does not need to treat annuity contracts and custodial accounts as part of the employer's Title I plan or as plan assets for purposes of ERISA's annual reporting requirements provided that:

1. The contract or account was issued to a current or former employee before January 1, 2009;
2. The employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and, in fact, ceased making contributions to the contract or account before January 1, 2009;
3. All of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer*; and
4. The individual owner of the contract is fully vested in the contract or account.

Moreover, current or former employees with only contracts or accounts that are excludable from the plan's Form 5500 or Form 5500-SF under the above transition relief do not need to be counted as participants covered under the plan for Form 5500 annual reporting purposes.

*Note that the fact that an individual's contract or account rights are reflected by an individual certificate under a group annuity contract held in the employer's name would not, for that reason alone, make the individual certificate ineligible for the transition relief described in this memorandum provided that the certificate gives the individual the ability to enforce all of his or her contract or account rights without any involvement by the employer.

Independent Audit

The Department will not reject a Form 5500 on the basis of a "qualified," "adverse," or "disclaimed" opinion if the accountant expressly states that the sole reason for such an opinion was because such pre-2009 contracts were not covered by the audit or included in the plan's financial statements. Except with respect to this relief, accountants engaged to perform audits of employee benefit plans must perform audit procedures and report in accordance with generally accepted auditing standards as required by ERISA and the Department's implementing regulations.

Guiding Principle

The DOL reiterates that it understands that 403(b) plans subject to Title I of ERISA may

encounter compliance issues unrelated to pre-2009 contracts in making the transition to the Form 5500 annual reporting and audit requirements generally applicable to Title I plans. Acknowledging that there may be instances when full annual reporting compliance by 403(b) plans may not be possible for the 2009 plan year, *the guiding principle must be to ensure that appropriate efforts are made to act reasonably, prudently, and in the interest of the plan's participants and beneficiaries.*

Although ERISA's annual reporting requirements may result in added costs to a plan, an administrator of a 403(b) plan administered in accordance with ERISA's fiduciary and other applicable requirements should be able to prepare an acceptable 2009 Form 5500 or Form 5500-SF without undue expense or burden. The DOL states it has noted in other contexts relating to ERISA's recordkeeping requirements that whether lost or destroyed records can, or should be, reconstructed and whether the persons responsible for retention of the plan's records are, or should be, personally liable for the costs incurred in connection with the reconstruction of records or other consequences of their loss or destruction are necessarily dependent on the facts and circumstances of each case. In that regard, we expect that accountants engaged to conduct employee benefit plan audits will notify plan administrators of questions, issues, and irregularities discovered as part of the audit engagement that could materially affect the plan's audit expenses or other costs associated with making the transition to ERISA's generally applicable annual reporting regime. Providing administrators with that compliance assistance information will help them ensure that decisions regarding use of plan assets to defray annual reporting costs are reasonable, prudent, and in the interest of the plan's participants and beneficiaries.

Questions concerning the information contained in FAB 2009-2 may be directed to the Division of Coverage, Reporting and Disclosure at 202.693.8523. Questions concerning individual plans facing specific transition issues should be directed to EBSA's Office of the Chief Accountant at 202.693.8360.

This guidance is welcome relief to industry practitioners who were concerned with what their responsibilities might have been with regard to old contracts over which they had no control and little or no data. This will make everyone's job easier. ■

403(b) Prototype Plan — Draft Stage

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Program Background

The IRS also requested entities that will be filing an opinion letter application as a §403(b) prototype plan sponsor to send an e-mail to state that intent. Mass submitters are to include an estimate of the number of opinion letter applications being sought for sponsors. The IRS has indicated that 40+ organizations have expressed an interest in being a prototype 403(b) sponsor.

As with any prototype program, the 403(b) prototype will provide adopting eligible employers with reliance as to the form of the document (though not in operation). It will also provide reliance that the plan is in compliance with Code Section 403(b) and the final 403(b) regulations, as well as the written plan requirements.

Responsibilities of the 403(b) Prototype Sponsor

Although the IRS is modeling the 403(b) Prototype Program on the qualified plan program, there are some proposed changes. According to the *draft procedure*, a prototype sponsor must:

1. Maintain a list of adopting employers.
2. Maintain the approved status of the plan, i.e., adopt amendments for law changes.
3. Create a procedure to verify that adopting employers have timely completed restatements when required.
4. Create a procedure to acknowledge receipt of amendments when a restatement is not required.
5. Create a procedure to correct compliance issues under EPCRS or to notify adopting employers about EPCRS if the sponsor determines that the employer's plan is no longer compliant with Code Section 403(b) or the final 403(b) regulations.

NOTE: Items 1, 2 and 5 above are also required of qualified plans.

Six-year Cycle

The IRS does not expect to accept applications for opinion letters for the 403(b) prototype before March 15, 2010. The IRS will announce when it will begin. The draft revenue procedure must be finalized first. Like other prototype plans, the prototype 403(b) plans will be subject to the six-year cycle, and thus, it can be anticipated that the IRS will use the first year for sponsor-drafting purposes and then approximately the next two years of the six-year cycle to review the documents that have been submitted. Thus, if an employer who has not

yet adopted a 403(b) document is wondering if he or she should wait for the prototype document, the answer is no; because he or she must adopt the 403(b) written plan document by December 31, 2009, and not wait for the prototype.

Reliance on McKay Hochman 403(b) Document

Any employer who adopted the McKay Hochman 403(b) written plan document in 2008 or 2009 does not need to amend the plan, at this time, to be in compliance with the final 403(b) regulations of 2007, as we have made a good faith "best effort" to be compliant with those regulations. As other amendments become necessary, we will be in touch with those who have licensed or who directly adopt our plans on a pay-per-plan or a single-use basis.

Highlights of the Draft Revenue Procedure:

- Prototypes will require full vesting of all contributions. (This major point of contention is anticipated to be changed in the final program.)
- An eligible §403(b) prototype plan sponsor is any company, firm, or individual that expects at least 30 eligible employers to adopt its §403(b) prototype plan basic plan document(s).
- A mass submitter is any person that submits opinion letter applications on behalf of at least 30 prototype sponsors that have adopted, on a word-for-word identical basis, the same basic plan document.
- A governmental plan under §414(d) or a nonelecting church plan may rely upon a favorable opinion letter that the form of its §403(b) prototype plan satisfies the requirements of §403(b). However, a favorable opinion letter is not a determination as to whether the plan is a §414(d) governmental plan or a nonelecting church plan.

Responsibilities of the 403(b) Prototype Sponsor

Although the IRS is modeling the 403(b) Prototype Program on the qualified plan program, there are some proposed changes:

A §403(b) prototype plan is standardized if:

- *Elective deferrals are the only contributions under the plan, or*
- *The plan provisions, other than for elective deferrals, benefit all eligible employers'*

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403(b) Prototype Plan — Draft Stage

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nonexcludable employees in the employers'-controlled group under a design-based nondiscrimination safe harbor allocation formula.

- *It is unclear as to how much flexibility will be permitted in nonstandardized plans.*

An eligible employer may rely upon a favorable opinion letter if the plan is a standardized plan and either:

1. The only contributions allowed under the plan are elective deferrals, or
2. All the employers in the adopting employer's controlled group are eligible employers.

An adopting eligible employer may NOT rely on the opinion letter with respect to whether contributions under the plan (other than elective deferrals) satisfy the requirements of Sections 401(a)(4) and 410(b) if either:

- The plan is not standardized, or
- The plan permits contributions other than elective deferrals and the adopting eligible employer's controlled group includes any employer that is not an eligible employer.

Once the 403(b) determination letter program is available, the adopting employer can request a determination letter to obtain reliance for §§401(a)(4) and 410(b). Governmental plans and nonelecting church plans are not subject to these requirements and may, therefore, rely on the opinion letter without regard to the form of the plan.

Document Overrides Contract and Account Terms

The IRS will not review annuity contracts or custodial accounts under the plan. The prototype plan's terms must satisfy the Code and regulations' requirements and thus, must override any contract or account terms that are inconsistent with the plan. Note that employers may provide multiple investment arrangements (for example, annuity contracts and custodial accounts) in a plan, or have different features in those arrangements.

Retroactive Remedial Amendment

A retroactive remedial amendment is allowed so that an eligible employer can retroactively correct defects in its written §403(b) plan's form by timely adopting an approved §403(b) prototype plan or by otherwise timely amending its plan and submitting a request for a determination letter once a determination letter program is available for §403(b) plans. The employer must amend its plan retroactively to the first day of the plan's remedial amendment period.

Written Plan Document Required

NOTE: Regardless of the preceding paragraph, the IRS requires a "best effort" written 403(b) plan document, compliant with the final 403(b) regulations of July 26, 2007, to be adopted effective January 1, 2009. Thus, employers who have not yet adopted a written 403(b) plan document must do so by no later than December 31, 2009 (with an effective date of January 1, 2009). Further, the IRS expects the 403(b) plan to have been operated in compliance with Code Section 403(b) and the final 403(b) regulations as of January 1, 2009.

The IRS will NOT issue letters for:

1. TEFRA church defined benefit plans;
2. Plans that include provisions applicable only to churches, qualified church-controlled organizations, church-related organizations, or ministers; or
3. Plans that provide graduated vesting. (Again, the IRS is reconsidering the vesting issue.)

ERISA Reliance Issues

An opinion letter provides reliance only for Title II of ERISA. Note that the IRS may decline to issue an opinion letter where the plan fails to satisfy a Code provision that is parallel to a provision in ERISA Part 2 of Subtitle B of Title I. ■

Although 403(b) Perspectives is drafted by ERISA attorneys, the answers to issues addressed herein do not constitute legal opinions of McKay Hochman Co., Inc., nor does McKay Hochman guarantee that the IRS and the DOL will agree with the content of this newsletter. Accordingly, readers of 403(b) Perspectives should consult their attorneys or tax advisors before relying on any of the statements herein. Please direct any questions or comments to William C. Grossman at 973-492-1880.
